No. 18438
No. 18439

United States
COURT OF APPEALS
for the Ninth Circuit

CUMMINS DIESEL SALES OF OREGON, INC., an Oregon corporation,
Plaintiff-Appellant,
vs.
UNITED STATES OF AMERICA,
Defendant-Appellee.
No. 18438

ROBERT H. WILLS and LILLIAN WILLS, husband and wife,
Plaintiffs-Appellants,
vs.
UNITED STATES OF AMERICA,
Defendant-Respondent.
No. 18439

APPELLANTS' REPLY BRIEF

Appeals from the United States District Court for the District of Oregon

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Re: Accumulated Earnings Tax

Contrary to what the government says (Govt. Br. 19) the taxpayer did not and does not deny that the

question of whether a corporation has accumulated its earnings and profits beyond reasonable business needs involves a factual determination. Neither does taxpayer deny that rule 52(a) of the Federal Rules of Civil Procedure applies to the trial court's finding. What was contended in appellant's brief, however, is that the reasonableness of the accumulation is really the *only* question here under the Section 531 appeal. If the accumulation of earnings and profits by the Cummins Corporation was unreasonable, the taxpayer must pay the penalty tax. But if the accumulation was reasonable, as we contend, there could not be any penalty tax to pay, by the very terms of Sections 531 and 533.

In other words, all of the space devoted in the government's brief to discussing tax avoidance purposes is beside the point. *The* point is: was the accumulation reasonable? If it was, it is nonsense to say that such reasonable accumulation was made for the prohibited tax-avoidance purpose. If this explanation is still "less than clear" to the government's counsel (Govt. Br. 29) we suggest that they actually calculate the penalty tax that would be due in this case utilizing an accumulated earnings credit in each of the two years in question equal to the earnings and profits for each such year, as would be the case if the accumulation each year was reasonable. Obviously the answer to such a calculation would show a penalty tax of $0. That result would follow even in the face of a purported finding that a tax avoidance purpose existed. Such a "finding" would be either meaningless under the circumstances or, at best, clearly erroneous. This is the reason why it was said in our opening

brief (Ap. Br. 9) that the key to the accumulated earnings tax appeal is the reasonableness or unreasonableness of the accumulation of earnings and profits in 1955 and 1956.

On this main (and in fact sole) issue, we observe that the government's brief nowhere denies that the Cummins Corporation did in fact grow substantially during the period from 1939 through 1956. Neither does it deny that this growth required an ever increasing amount of earnings and profits to be retained in the business to finance such things as

1. inventories,
2. accounts receivable,
3. operating expenses, and
4. new plant and facilities,

all as spelled out in detail in the opening brief (Ap. Br. 12-18).

We do wish to point out, however, that the references (Govt. Br. 16, 31) to a financial adviser of Mr. Wills having conceded a tax avoidance purpose of the accumulation is not a fair interpretation of the evidence. The testimony alluded to, in full context, may be found at pages 98 and 99 of the transcript, and the Court's attention is invited thereto. It would appear that, in making such references, the government is overlooking a fundamental distinction voiced by the trial court in reference to that same financial adviser. Thus the Court opined that the accountant witness was hired to "keep the taxes at the lowest possible level consistent with legality." It is of course true, and nowhere denied, that

the retention of earnings and profits in this case resulted in less taxes being paid than if the accumulations had been distributed. But, as shown by the cases cited in the opening brief (Ap. Br. 19, 20), that fact is of no consequence where, as here, the accumulations were reasonable.

Since the accumulations were necessary for business purposes, there was no impropriety in the officers of the corporation, or the financial advisers to the corporation, being aware of the obvious fact that retained earnings and profits are not taxed as dividends. Neither was there any impropriety in discussing that fact. Surely the government is not suggesting that a proper retention of earnings and profits becomes improper merely because the taxpayer or its advisers knows that such retention will result in less taxes.

Re: Services of the Nurse

The government says (Govt. Br. 33) that the trial court's disposition of this issue "finds ample support in *Commissioner* v. *Doak,* 234 F.2d 704 (C.A. 4th), and *Sparkman* v. *Commissioner,* 112 F.2d 774 (C.A. 9th)." Just what that "ample support" consists of is left to the reader's imagination. Reading those cases discloses no basis for the trial courts' action in the instant case.

We likewise challenge the assertion (Govt. Br. 34) that *Allenberg Cotton Co.* v. *United States* (61-1 U.S. T.C. par. 9131) is "clearly distinguishable on its facts" from the instant case. It is true, as the government says, that the *Allenberg case* involved "constant travel abroad", and it is likewise true that in the case below,

Mr. Wills made no attempt to allocate the nurse's time between nursing and other work. But of what relevance is this? In the *Allenberg* case the services in question were entirely nursing services, and yet they were held to be deductible. Here the government has conceded (Govt. Br. 33) that such services were not exclusive. *A Fortiori,* then, payment for such services here should be deductible (unless, that is, the government denies that payment for the secretarial duties was an ordinary and necessary business expense). The fact that the *Allenberg* case involved "constant travel abroad" is not a distinguishing factor from the instant case since the nurse here was not hired or paid except when Mr. Wills was traveling (R. 108).

CONCLUSION

The judgments entered were clearly in error and should be reversed.

Respectfully submitted,

GEORGE W. MEAD,
Attorney for Plaintiffs-Appellants

Certificate

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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Attorney